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FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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Q92-2229

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

for the quarterly period ended March 31, 1992

OR

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 1-3490

BEST COPY AVAILABLE

PENNSYLVANIA GAS AND WATER COMPANY

(Exact name of registrant as specified in its charter)

Pennsylvania	24-0717235
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
Wilkes-Barre Center, 39 Public Square Wilkes-Barre, Pennsylvania (Address of principal executive offices)	18711-0601 (Zip Code)

L30

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(717) 829-8843

(Registrant's telephone number including area code)

Indicate by check mark whether (1) the registrant has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No _

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Registrant had 3,870,900 shares of common stock, no par value, outstanding as of April 22, 1992.

PENNSYLVANIA GAS AND WATER COMPANY

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PART I. FINANCIAL INFORMATION

PENNSYLVANIA GAS AND WATER COMPANY

STATEMENTS OF INCOME

	Three Months Ended March 31,	
	1991	1992
	(Thousands of Dollars)	
OPERATING REVENUES:		
Gas	$ 60,326	$ 58,995
Water	8,065	11,678
Total operating revenues	68,391	70,673
OPERATING EXPENSES:		
Cost of gas	36,872	33,651
Other operation expenses	9,675	9,675
Maintenance	2,215	2,130
Depreciation	2,281	2,787
Deferred treatment plant costs	(765)	-
Income taxes	3,105	4,599
Other taxes	4,254	5,211
Total operating expenses	57,637	58,053
OPERATING INCOME	10,754	12,620
OTHER INCOME, NET	87	176
INCOME BEFORE INTEREST CHARGES	10,841	12,796
INTEREST CHARGES:		
Interest on long-term debt	4,440	4,999
Other interest	898	1,215
Allowance for borrowed funds used during construction	(54)	(240)
Deferred treatment plant interest	(929)	-
Total interest charges	4,355	5,974
NET INCOME	6,486	6,822
DIVIDENDS ON PREFERRED STOCK	1,059	1,059
EARNINGS APPLICABLE TO COMMON STOCK	$ 5,427	$ 5,763
COMMON STOCK:		
Weighted average number of shares outstanding	3,681,934	3,713,273
Earnings per share	$ 1.47	$ 1.55
Cash dividends per share	$ .60	$ .705

The accompanying notes are an integral part of the financial statements.

PENNSYLVANIA GAS AND WATER COMPANY

BALANCE SHEETS

	December 31, 1991	March 31, 1992
	(Thousands of Dollars)	
ASSETS		
UTILITY PLANT:		
Gas plant, at original cost less acquisition adjustments of $386,000	$ 223,655	$ 225,857
Water plant, at original cost plus acquisition adjustments of $14,236,000	289,708	295,846
Common plant, at original cost	25,123	25,189
	538,486	546,892
Accumulated depreciation	(71,044)	(73,882)
	467,442	473,010
OTHER PROPERTY AND INVESTMENTS	2,348	2,268
CURRENT ASSETS:		
Cash	658	629
Accounts receivable -		
Customers	20,030	22,996
Others	391	364
Reserve for uncollectible accounts	(1,607)	(1,829)
Intercompany advance	15,000	-
Accrued utility revenues	12,331	10,897
Materials and supplies, at average cost	3,547	3,542
Gas held by suppliers, at average cost	20,026	2,469
Prepaid expenses and other	2,873	5,025
	73,249	44,093
DEFERRED CHARGES:		
Unamortized debt expense	2,730	2,465
Capital stock expense	1,246	771
Deferred treatment plant costs and interest	5,146	5,146
Deferred water utility billings	3,385	4,288
Other	8,971	8,640
	21,478	21,310
TOTAL ASSETS	$ 564,517	$ 540,681

The accompanying notes are an integral part of the financial statements.

PENNSYLVANIA GAS AND WATER COMPANY

BALANCE SHEETS

	December 31, 1991	March 31, 1992
	(Thousands of Dollars)	
CAPITALIZATION AND LIABILITIES		
CAPITALIZATION:		
Common shareholder's investment	$ 147,678	$ 157,460
Preferred stock -		
Not subject to mandatory redemption	9,916	9,916
Subject to mandatory redemption	42,000	42,000
Long-term debt	194,853	162,979
	394,447	372,355
CURRENT LIABILITIES:		
Current portion of long-term debt and preferred stock subject to mandatory redemption	57,480	57,491
Accounts payable -		
Suppliers	21,156	15,955
Affiliates, net	1,191	1,155
Deferred cost of gas and supplier refunds, net	11,984	11,486
Accrued general business and realty taxes	3,090	3,475
Accrued income taxes	2,091	6,134
Accrued interest	5,523	4,627
Other	1,831	1,884
	104,346	102,207
DEFERRED CREDITS:		
Deferred income taxes	31,768	32,265
Unamortized investment tax credits	9,695	9,631
Advances for construction	9,941	10,021
Contributions in aid of construction	8,189	8,188
Operating reserves	1,847	1,901
Other	4,284	4,113
	65,724	66,119
COMMITMENTS AND CONTINGENCIES (Note 4)		
TOTAL CAPITALIZATION AND LIABILITIES	$ 564,517	$ 540,681

The accompanying notes are an integral part of the financial statements.

PENNSYLVANIA GAS AND WATER COMPANY

STATEMENTS OF CASH FLOWS

	Three Months Ended March 31,	
	1991*	1992
	(Thousands of Dollars)	
CASH FLOW FROM OPERATING ACTIVITIES:		
Net income	$ 6,486	$ 6,822
Effects of noncash charges to income -		
Depreciation	2,285	2,790
Deferred income taxes, net	1,164	497
Provision for self insurance	240	240
Deferred treatment plant costs and interest	(1,695)	-
Deferred water utility billings	(7)	(1,119)
Other, net	989	906
Changes in working capital, exclusive of cash and current portion of long-term debt -		
Receivables and accrued utility revenues	(2,909)	(1,283)
Gas held by suppliers	15,566	17,557
Other current assets and liabilities, net	6,588	1,654
Accounts payable	(8,156)	(4,280)
Deferred cost of gas and supplier refunds, net	6,000	(498)
Other operating items, net	(90)	(337)
Net cash provided by operating activities	26,441	22,949
CASH FLOW FROM INVESTING ACTIVITIES:		
Additions to utility plant	(5,515)	(8,669)
Other, net	287	108
Net cash used for investing activities	(5,228)	(8,561)
CASH FLOW FROM FINANCING ACTIVITIES:		
Issuance of common stock	137	7,090
Dividends on common and preferred stock	(3,269)	(3,664)
Repayment of long-term debt	(1,340)	(1,863)
Collection of intercompany advance	-	15,000
Net decrease in bank borrowings	-	(30,957)
Other, net	-	(23)
Net cash used for financing activities	(4,472)	(14,417)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	16,741	(29)
CASH AT BEGINNING OF YEAR	2,013	658
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 18,754	$ 629
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest (net of amount capitalized)	$ 3,826	$ 4,795
Income taxes	$ -	$ 106

*Reclassified to conform with 1992 financial statement presentation.

The accompanying notes are an integral part of the financial statements.

PENNSYLVANIA GAS AND WATER COMPANY

NOTES TO FINANCIAL STATEMENTS

(1) GENERAL

The interim financial statements included herein have been prepared by Pennsylvania Gas and Water Company (PG&W), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although PG&W believes that the disclosures are adequate to make the information presented not misleading.

The results for the interim periods are not necessarily indicative of the results to be expected for the year, primarily due to the effect of seasonal variations in weather. However, in the opinion of management, all adjustments, consisting of only normal recurring accruals, necessary to present fairly the results for the interim periods have been reflected in the financial statements. It is suggested that these financial statements be read in conjunction with the financial statements and the notes thereto included in PG&W's latest annual report on Form 10-K.

(2) RATE MATTERS

Gas Rate Filings

Annual Gas Cost Adjustment. Pursuant to the provisions of the Pennsylvania Public Utility Code, which require that the tariffs of gas distribution companies, such as PG&W, be adjusted on an annual basis to reflect changes in their purchased gas costs, the PPUC ordered PG&W to make the following changes to the gas costs contained in its gas tariff rates on the dates indicated:

Effective Date	Change in Rate per Thousand Cubic Feet From	To	Calculated Increase (Decrease) in Annual Revenue
December 1, 1990	$3.02	$3.20	$ 4,200,000
December 1, 1991	3.20	2.46	(20,800,000)

Such changes in gas rates have no effect on PG&W's earnings since the change in revenue is offset by a corresponding change in the cost of gas.

Recovery of Take-or-Pay Costs. On April 27, 1990, PG&W filed an application with the PPUC seeking approval to recover 90% ($13.9 million based on then current estimates) of its total take-or-pay liabilities, and $250,000 of related carrying costs, through billings to customers over a four-year period beginning June 1, 1990. The PPUC approved this application effective June 1, 1990. In connection with this approval, PG&W agreed to absorb a portion of its take-or-pay liabilities. The amount to be so absorbed by PG&W is currently estimated to range between $1.7 million and $1.9 million, of which $1.7 million had been charged to expense as of March 31, 1992. As of March 31, 1992, PG&W had billed $8.3 million of take-or-pay costs to its customers and had deferred $4.3 million of such costs, including related carrying charges, for future billing to customers.

Under the terms of the PPUC's Order in respect of take-or-pay obligations, the surcharge by which PG&W bills its customers for take-or-pay costs is to be adjusted annually as of June 1 to reflect changes in PG&W's total estimated liability for take-or-pay costs (which is currently projected to be as much as $19.1 million) and the portion of such costs remaining to be recovered from its customers. In accordance therewith, PG&W has filed data with the PPUC requesting approval by the PPUC of an adjustment in PG&W's take-or-pay surcharge effective June 1, 1992, based on the $9.2 million of take-or-pay costs that PG&W currently estimates will remain to be collected from its customers as of such date.

Water Rate Filings

Scranton Area Water Rate Increase. On June 8, 1990, PG&W filed an application with the PPUC seeking a water rate increase, designed to produce $25.5 million in additional annual revenue to be effective August 7, 1990. This rate increase request involved the approximately 54,700 customers who are now being furnished water from the one previously existing and the four new water treatment plants in the Scranton Water Rate Area. By Order entered July 16, 1990, the PPUC allowed this rate increase to be suspended for seven months (until March 7, 1991) by operation of law and instituted an investigation into the reasonableness of the proposed rates. Subsequent to the entry of the PPUC's Order, PG&W agreed to extend the suspension period for an additional 39 days (until April 15, 1991), in order to allow sufficient time for it to submit certain required data and for the PPUC to fully conduct its investigation.

On December 21, 1990, PG&W, the PPUC Office of Trial Staff, the Office of Consumer Advocate, the Office of Small Business Advocate and Pennsylvania-American Water Company (a customer to whom PG&W supplies water for resale) filed a Joint Petition for Settlement ("Settlement Petition") with the Administrative Law Judge assigned to conduct the investigation of the proposed rate increase. This Settlement Petition provided for a 11O% rate increase designed to produce $15.0 million of additional annual revenue to be phased-in over a two-year period under the terms of a qualified phase-in plan, pursuant to FASB Statement 92 entitled "Regulated Enterprises-Accounting for Phase-in Plans." The Settlement Petition further provided that $10.2 million of the increased revenue (an approximate 75% increase in rates) was to be realized through an immediate rate increase and that the remaining $4.8 million of the increased revenue (an additional 35% increase in rates) was to be realized through a further rate increase one year later (i.e., at the beginning of year two of the phase-in period). The Settlement Petition also specified that the $4.8 million in billings that would be so deferred during the first year of the phase-in period was to be collected from customers in the form of a surcharge in years two through ten of the phase-in period. By Order adopted March 22, 1991, the PPUC approved the Settlement Petition and permitted PG&W a water rate increase estimated to produce additional annual revenue of $15.0 million, effective March 23, 1991. In accordance with the provisions of FASB Statement 92, PG&W commenced recording the entire $15.0 million increase in annual revenue allowed by the PPUC as additional revenue beginning March 23, 1991. However, pursuant to the terms of the Settlement Petition, PG&W deferred the billing of $4.8 million of the increased revenue recorded during the first year of the phase-in period (i.e. the period March 23, 1991, through March 22, 1992). Effective March 23, 1992, PG&W began to bill such amount by means of the surcharge that will be in effect in years two through ten of the phase-in period, and as of March 31, 1992, $1,600 had been so billed to its Scranton Water Rate Area customers.

Deferred Treatment Plant Costs and Interest. As approved by an Order of the PPUC entered September 5, 1990, PG&W deferred all operating expenses, including depreciation and property taxes, and the carrying charges (equivalent to the allowance for borrowed funds used during construction) relative to the four new Scranton Area water treatment plants and related facilities from the dates of commercial operation of the plants until March 23, 1991, the effective date of the Scranton Area water rate increase approved by the PPUC on March 22, 1991. As of March 31, 1992, a total of $5.1 million of costs, consisting of $2.3 million of operating expenses and $2.8 million of carrying charges, had been so deferred pursuant to the PPUC's Order permitting the deferral of these costs. The deferral of these costs resulted in an increase in earnings in the first quarter of 1991 of $981,000, net of related income taxes. PG&W intends to seek recovery of such amounts in its next rate increase request relative to the Scranton Water Rate Area. In the opinion of PG&W, the recovery of these costs will be allowed by the PPUC in future rates.

Nesbitt Service Area Water Rate Increase. On April 30, 1991, PG&W filed an application with the PPUC seeking a water rate increase, designed to produce $2.6 million in additional annual revenue. This rate increase request involved the approximately 14,300 customers in the Spring Brook Water Rate Area who are served exclusively by the Nesbitt Water Treatment Plant. PG&W and certain parties filing objections to the rate increase request reached a settlement that provided for a $1.9 million increase in annual revenue which the PPUC approved effective January 30, 1992. On February 6, 1992, the Office of Consumer Advocate ("OCA"), a complainant in the rate proceeding and a signatory to the settlement, filed a petition for reconsideration and clarification of the PPUC Order which approved the settlement. On February 18, 1992, PG&W filed an answer to the OCA's petition. By Order entered February 27, 1992, the PPUC granted the OCA's petition and, as a result, the $1.9 million rate increase remains subject to further PPUC and possible appellate review. Although it cannot be certain, PG&W believes that the $1.9 million increase will not be rescinded in whole or in part or affected in any other way as a result of the OCA's petition.

(3) POSTRETIREMENT BENEFITS

In December, 1990, FASB Statement 106 "Employers' Accounting for Postretirement Benefits Other Than Pensions" was issued. The provisions of this statement, which PG&W must adopt in 1993, will require PG&W to record the cost of retiree health care and life insurance benefits as a liability over the employees' active service periods instead of on a benefits paid basis as is PG&W's current practice. Preliminary actuarial studies indicate that PG&W's unfunded accumulated obligation for postretirement benefits other than pensions (the "transition obligation") will approximate $32.2 million as of January 1, 1993, and that PG&W's accrued costs for postretirement benefit obligations other than pensions, including amortization of the transition obligation, will be approximately $5.3 million in 1993, based on the provisions of FASB Statement 106. These amounts are preliminary estimates. PG&W is continuing to review various assumptions and alternatives which may significantly reduce such estimates. On a benefits paid basis (PG&W's current practice), the estimated cost of such benefits in 1993 would be approximately $1.2 million. Nevertheless, the provisions of FASB Statement 106 are not expected to have a significant effect on PG&W's results of operations, since it expects that the PPUC will authorize it to recover in rates the additional costs which will be accrued pursuant to the provisions of FASB Statement 106.

(4) COMMITMENTS AND CONTINGENCIES

Construction of Water Treatment Facilities

On December 22, 1983, the Pennsylvania Department of Health advised PG&W that data collected over the prior two months indicated a higher than normal incidence of giardiasis in some of the municipalities served by PG&W's Spring Brook Intake Reservoir. Giardiasis is a flu-like disease that is transmitted by the giardia cyst, a microscopic organism, which can be waterborne. In January, 1984, giardia cysts were confirmed as being present in samples of water taken from the distribution system served by the Spring Brook Intake Reservoir. During March, 1984, the cysts were also found to be present in samples of water taken from the distribution system served by PG&W's Elmhurst Reservoir. These findings resulted in approximately 73,600 of PG&W's 127,900 water customers being advised to boil water for varying periods during 1984, the issuance of Orders by the Pennsylvania Department of Environmental Resources ("DER") requiring PG&W to construct filtration plants to treat the water entering its distribution system from the Spring Brook Intake, Nesbitt and Elmhurst Reservoirs and to take various other actions relative to its water utility operations, and an investigation by the PPUC regarding the propriety of adjusting the rates of the customers in question, which, among other things, resulted in the issuance of credits by PG&W in 1984 totaling $909,000.

The presence of giardia cysts also resulted in the decision by PG&W to construct two large water treatment plants to provide for filtration of the water supplies which were subject to Orders issued by the DER, as well as certain of PG&W's other water supplies. The estimated cost of these water treatment plants, and associated distribution system facilities, is $49.9 million, of which $48.4 million had been expended as of March 31, 1992. One of these plants, known as the Nesbitt Water Treatment Plant, which provides for treatment of water from the Nesbitt and Spring Brook Intake Reservoirs, was placed in service in May, 1988. The other plant, known as the Scranton Area Water Treatment Plant, which provides for treatment of water from the Elmhurst Reservoir and certain other supplies, was completed in June, 1990, and became fully operational in July, 1990. These plants will also require the construction of related wastewater facilities, which will involve a currently estimated expenditure of $7.8 million during the period 1992 through 1996.

Additionally, PG&W has adopted a plan involving the construction of six other water treatment plants and associated water supply and distribution system improvements, as well as certain previously planned dam modifications. One of these additional water treatment plants (the Brownell Water Treatment Plant) was completed and placed in service in June, 1990, and two others (the Chinchilla and Fallbrook Water Treatment Plants) were completed and placed in service in July, 1990. Of the three remaining water treatment plants, each of which will serve a portion of the Spring Brook Rate Area, one (the Crystal Lake Water Treatment Plant) is scheduled for completion in the summer of 1992 and the two other plants (the Ceasetown and Watres Water Treatment Plants) are each currently scheduled to be completed in late 1993. The construction of these six plants and associated facilities, which will result in the filtration of all PG&W's regularly used water supplies, will, along with the previously planned dam modifications, cost $124.1 million based on current estimates, of which $48.3 million had been expended as of March 31, 1992. The continuation of this program and the expenditure of the approximate $75.8 million required for its completion is dependent upon PG&W and its parent company, Pennsylvania Enterprises, Inc. ("PEI"), being able to raise the necessary capital in a timely manner.

Although it cannot be certain, PG&W does not believe that its construction of the water treatment plants, the associated water supply and distribution system improvements and the previously planned dam modifications, as described above, should have a material adverse effect on its financial position, other than for "regulatory lag," since the expenditures for such facilities should be recoverable in the future rates charged by PG&W for water service.

Construction Litigation

On April 22, 1992, a complaint was filed in the Court of Common Pleas of Lackawanna County, Pennsylvania by the Quandel Group, Inc. ("Quandel") against PG&W in connection with the construction of PG&W's Brownell Water Treatment Plant. Specifically, Quandel, the general contractor for this project, alleges that (i) PG&W has not paid Quandel for work in connection with certain change orders issued by PG&W, (ii) PG&W has not paid Quandel for work done beyond the requirements of its contract to remediate defects resulting from improper designs furnished by PG&W, and (iii) on account of breaches by PG&W, Quandel could not complete the work to be done under the contract within the agreed contract period and was forced to incur additional costs in performing such work for which it has not been compensated. Quandel seeks approximately $1.3 million in damages plus interest. Although it cannot be certain because this proceeding is in its earliest stages, PG&W believes that this complaint is without merit and that it will prevail in this action. Furthermore, PG&W believes that in the event it does not prevail in this action, Gannett-Fleming Water Resources Engineers, Inc., the designer of the project, will be responsible for part of any damages that may be awarded. In addition, PG&W believes that a substantial portion of any amounts it might be required to pay as a result of this action would be recoverable in future rates as costs properly associated with the construction of water treatment facilities.

Giardiasis Litigation

There are currently five class action suits and two individual suits pending against PG&W, and in certain instances against PEI, in connection with the presence of giardia cysts in the distribution systems served by PG&W's Spring Brook Intake and Elmhurst Reservoirs. PG&W is vigorously contesting these suits. Although some of these suits involve claims for substantial amounts, and although PG&W cannot be certain since the actions are still in their preliminary stages, PG&W believes that it has adequate insurance to cover any liability that may foreseeably result from these suits and, therefore, that they should not have a material adverse effect on its financial position or its results of operations.

Agreement with Department of Environmental Resources

On December 20, 1988, PG&W and the Pennsylvania Department of Environmental Resources ("DER") entered into a Consent Order and Agreement (the "Consent Order"), the terms and conditions of which, among other things, require PG&W to provide for the filtration of all water supplies serving the Spring Brook Water Rate Area by the end of 1992, subject to "force majeure" extensions in such deadline if approved by DER, to pay civil penalties of $1,000 per day for each day and for each instance in which completion of the planned treatment plants is delayed beyond their respective specified completion dates, to pay $1,000 per day for each day certain other requirements are not met, and to take certain other actions with respect to its water supplies, including continued operation of interim treatment facilities until replaced by water treatment plants. Under the terms of the Consent Order, the DER agreed not to seek civil penalties for turbidity violations if PG&W met the specified completion dates for the water

treatment plants. Except for meeting the deadline specified for the filtration of all water supplies serving the Spring Brook Water Rate Area, which will require the completion of the three water treatment plants that are now under construction, PG&W believes it will comply with the various requirements of the Consent Order. Only one of the three plants now under construction (the Crystal Lake Water Treatment Plant) is expected to be completed by the December 31, 1992, deadline specified in the Consent Order. Completion of the two other plants (the Ceasetown and Watres Water Treatment Plants) is not anticipated until late in 1993.

On August 16, 1991, PG&W requested a one-year extension until December 31, 1993, for reasons of "force majeure," in the deadline specified in the Consent Order relating to the filtration of water supplies in the Spring Brook Water Rate Area and, in particular, the completion of the Ceasetown and Watres Water Treatment Plants. On February 27, 1992, the DER denied such request on the basis that it did not comply with the provisions of the Consent Order regarding requests for extension because of "force majeure." PG&W intends to vigorously contest such denial, and, to such extent, it has filed an appeal thereto with the Environmental Hearing Board of the Commonwealth of Pennsylvania. PEI believes that in view of the magnitude of the effort required in providing for the filtration of all of PG&W's water supplies, the cost of such program, the low level of PG&W's earnings because of the past denial of water rate relief by the PPUC, and restrictions on the financing capabilities of both PEI and PG&W from October 1, 1990, to September 12, 1991, when PG&W issued its 9.57% Series First Mortgage Bonds, the level of civil penalties which have been previously imposed on PG&W for failure to meet completion deadlines and because other water companies face similar problems in complying with the deadlines imposed by the DER relative to the filtration of their water supplies, PG&W should be granted the requested extension and should not be subjected to any penalties for failure to complete the total filtration of all its water supplies by December 31, 1992. However, even if PG&W is ultimately assessed civil penalties for failure to meet the December 31, 1992, deadline specified in the Consent Order, it does not believe that any such penalties would have a material adverse effect on its operations or financial position.

Show Cause Order of Pennsylvania Public Utility Commission

On October 23, 1986, the PPUC entered an Order (the "1986 Show Cause Order") directing PG&W to show cause why it should not be fined for its failure to provide adequate, efficient, safe and reasonable water service and why PG&W should not be ordered to correct certain alleged operational deficiencies. Among the alleged operational deficiencies cited by the PPUC were PG&W's failure to filter all of the water it obtains from surface water supplies, its failure to examine the feasibility of constructing chlorine contact tanks at reservoirs as an interim measure pending the construction of filtration facilities, and its failure to recognize and develop plans for the problems caused by the interaction of its water with lead-lined service pipes. PG&W filed a response to the PPUC's 1986 Show Cause Order denying the allegations that it failed to provide adequate, efficient, safe and reasonable water service and pointing out that numerous actions had been taken or initiated to improve the quality of water supplied to its customers. After hearings on the matter before a PPUC Administrative Law Judge, an agreement to settle the proceedings initiated by the 1986 Show Cause Order was reached by PG&W and other parties and was subsequently approved by the PPUC on July 8, 1988.

The terms and conditions of such agreement provide, among other things, for PG&W to continue with planning and constructing the necessary facilities with the objective of providing for the total filtration of its water supplies by the

end of 1992; to remove all lead-lined services from its water distribution system by the end of 1991 (which was accomplished); to install an average of 14 miles of pipe per year during the period 1988 through 1992 to replace existing water mains and to eliminate dead ends; to contribute up to $125,000 to a special fund to assist low and fixed income households in making plumbing repairs and alterations necessary to accommodate the installation of water meters; and to forego the common equity return on $900,000, amortized over a ten-year period ending in 1998, of the capital utilized in financing the construction of new water facilities.

Except for the reduction in revenues resulting from the forbearance of the common equity return on $900,000 of capital expenditures and the contributions it is required to make for plumbing repairs and alterations in connection with the installation of meters, PG&W does not believe that the settlement agreement will result in any adverse effect on its financial position, since the PPUC has allowed PG&W to recover in rates certain costs related to the aforementioned expenditures required under the terms of the settlement agreement. Additionally, while not all of PG&W's water supplies will be filtered by the end of 1992, PG&W does not believe that the failure to meet such date will result in any material penalty being imposed by the PPUC because PG&W has implemented and is in compliance with all of the other requirements of the settlement reached in connection with the 1986 Show Cause Order and is proceeding with the construction of facilities which will provide for the total filtration of its water supplies by late 1993.

Water Quality Complaints

Beginning on June 24, 1991, Old Forge Borough Council and several other government entities and officials in Lackawanna County, Pennsylvania, filed formal complaints with the PPUC alleging that because the quality of water service provided by PG&W to customers in the Scranton Water Rate Area was allegedly below the minimum standards of the PPUC prior to June 24, 1991, the rates charged for such service were unjust and unreasonable. The complainants request that the PPUC schedule hearings on the matter and order an award of refunds or set-offs of charges payable by customers in PG&W's Scranton Water Rate Area if it is found that the quality of such water service was inadequate and below the standards of the PPUC. The complainants also request that the PPUC make specific findings of liability for damages, injuries, consequential expenses and costs resulting from PG&W's alleged failure to provide adequate water service to customers in PG&W's Scranton Water Rate Area in order to permit the complainants to recover monetary compensation before the Lackawanna County Court of Common Pleas. PG&W filed a motion to dismiss the complaints on procedural grounds which was subsequently denied by the presiding PPUC Administrative Law Judge. Although it cannot be certain because these proceedings are in their earliest stages, PG&W believes that the complaints are without merit, that they have no legal basis, and that it will prevail in these actions.

Manufactured Gas Plant Sites

PG&W, like many gas distribution companies, once utilized manufactured gas plants in connection with providing gas service to its customers. None of these plants has been in operation since 1960, and several of the plant sites are no longer owned by PG&W. Pursuant to the Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA"), PG&W filed notices with the United States Environmental Protection Agency (the "EPA") with respect to the former plant sites. None of the sites is or was formerly on the proposed or final National Priorities List. The EPA has conducted site inspections and made

preliminary assessments of each site and has concluded that no further remedial action is planned. While this conclusion does not constitute a legal prohibition against further regulatory action under CERCLA or other applicable federal or state law, PG&W does not believe that additional costs, if any, related to these manufactured gas plant sites will be material to its financial position.

Liquidity and Capital Resources

PG&W believes that based on its current financial projections, it will be able to achieve sufficient levels of earnings during 1992, as a result of the $15.0 million and $1.9 million water rate increases that were effective March 23, 1991, and January 30, 1992, respectively, the utilization of $22.0 million received from PEI on January 30, 1992, to repay a portion of its bank borrowings, and various cost reduction measures, to enable it to meet its interest and fixed charge coverage requirements and to give it the borrowing and other financing capability necessary for its working capital needs and planned construction program. If PG&W is not granted adequate future water rate increases in 1993 and subsequent years, it will be necessary for PG&W to take various actions to reduce expenditures in order to satisfy its interest and fixed charge coverage requirements and to maintain sufficient liquidity, and thereby lessen the amount of debt and equity capital which must be raised. Among other things, such actions could involve halting further work on PG&W's water treatment plants and other planned construction, which could result in a violation of the Consent Order and potential civil penalties.

Refinancing of Currently Maturing Long-Term Debt

In October, 1987, PG&W issued a promissory note in the principal amount of $50.0 million in connection with the issuance by the Luzerne County Industrial Development Authority ("Authority") of $50.0 million of 1987 Series A Exempt Facilities Revenue Bonds due, 2017 ("1987 Series A Bonds). The 1987 Series A Bonds are secured by a letter of credit issued by Swiss Bank Corporation, New York Branch ("SBC") pursuant to a Letter of Credit Agreement dated as of October 1, 1987, as amended (the "SBC Letter of Credit") which will expire on October 20, 1992. The 1987 Series A Bonds are required to be secured by either a letter of credit or by other comparable credit enhancement throughout their term. If the SBC Letter of Credit is not extended or renewed and if PG&W is not able to secure a replacement letter of credit or obtain comparable credit enhancement, PG&W would be required to either collateralize the 1987 Series A Bonds or purchase or cause their redemption as of October 1, 1992. SBC has indicated to PG&W that currently it does not intend to extend or renew the SBC Letter of Credit. Accordingly, PG&W intends to pursue the two following alternatives in the following order: (i) obtain a replacement letter of credit or other comparable credit enhancement, and (ii) collateralize the 1987 Series A Bonds. However, there can be no assurance that PG&W will be successful in obtaining either alternative because it is more difficult now, in general, to obtain such credit enhancement and if such enhancement is not available, PG&W's lenders may be unwilling to consent to the release of collateral to secure the 1987 Series A Bonds. If PG&W were unable to obtain either of these two alternatives with respect to the 1987 Series A Bonds, PG&W would seek to issue approximately $50.0 million in first mortgage bonds or other long-term debt in order to finance the redemption or purchase of the 1987 Series A Bonds, which would, in such a circumstance, be due on October 1, 1992. While PG&W believes it will be able to successfully complete the sale of first mortgage bonds or other long-term debt, there can be no assurance that PG&W will be successful in completing such sale or in obtaining either of the two alternatives described above. The failure to successfully obtain any of such alternatives could, absent waivers, result in a

default under the trust indenture dated as of October 1, 1987, between the Authority and Northeastern Bank of Pennsylvania, as trustee, pursuant to which the 1987 Series A Bonds were issued, cause cross-defaults under other debt instruments of PG&W and PEI and the potential acceleration of debt of PG&W and PEI, all of which would, if such acceleration occurs, have a material adverse effect on PEI and PG&W.

PEI presently has $19.0 million of debt outstanding under a Loan Agreement, dated as of December 1, 1989, as amended (the "Second LTCB Agreement"), between PEI and The Long-Term Credit Bank of Japan, Limited, New York Branch ("LTCB") and a Loan Agreement, dated as of January 18, 1990, as amended (the "FEB Agreement"), between PEI and First Eastern Bank, N.A. ("First Eastern"), which is due on July 15, 1992, and which it intends to repay with the proceeds from other borrowings. PG&W's existing revolving bank credit agreement (the "Credit Agreement") provides that in the event that PEI has not received by June 15, 1992, a commitment letter reasonably satisfactory to the banks who are parties to the Credit Agreement providing for a loan to PEI of at least $19.0 million, PG&W would become obligated, absent a waiver, to repay all amounts outstanding under the Credit Agreement on June 15, 1992. While PEI believes that it will be able to obtain a commitment letter satisfactory to the banks by June 15, 1992, there can be no assurance that it will be able to do so. In the event that PG&W is obligated to repay all amounts outstanding under the Credit Agreement on June 15, 1992, but is unable to do so or to obtain a waiver, PG&W would be in default under the Credit Agreement. Such default would, absent waivers, result in cross-defaults under other debt instruments of PG&W and the potential acceleration of other debt of PG&W, all of which would, if such acceleration occurs, have a material adverse effect on PEI and PG&W.

In addition, if PEI obtains such a commitment letter but does not actually receive the $19.0 million by July 15, 1992, PEI would be unable to repay its debt to LTCB and First Eastern on the July 15, 1992, due date. In such a circumstance, PEI would attempt to negotiate extensions of the due date of such debt in order to avoid a default under the terms of the Second LTCB Agreement and the FEB Agreement. A default would, absent waivers, cause cross-defaults under other debt instruments of PG&W and the potential acceleration of debt of PG&W, all of which would, if such acceleration occurs, have a material adverse effect on PG&W.

If PEI and PG&W were unable to successfully obtain any of the waivers described in the two preceding paragraphs, PEI and PG&W would seek to refinance or restructure the applicable debt obligations. If these efforts were unsuccessful and a substantial amount of PEI's and PG&W's debt was accelerated and became immediately due, PEI and PG&W might be forced to seek protection under federal bankruptcy laws.

RESULTS OF OPERATIONS

The following table expresses certain items in PG&W's statements of income as percentages of total operating revenues for each of the three-month periods ended March 31, 1991, and March 31, 1992:

	Percentage of Operating Revenues Three Months Ended March 31,	
	1991	1992
OPERATING REVENUES:		
Gas	88.2%	83.5%
Water	11.8	16.5
Total operating revenues	100.0	100.0
OPERATING EXPENSES:		
Cost of gas	53.9	47.6
Other operation expenses	14.1	13.7
Maintenance and depreciation	6.6	7.0
Deferred treatment plant costs	(1.1)	-
Income and other taxes	10.8	13.8
Total operating expenses	84.3	82.1
OPERATING INCOME	15.7	17.9
OTHER INCOME, NET	0.1	0.3
INTEREST CHARGES	6.4	8.5
DIVIDENDS ON PREFERRED STOCK	1.5	1.5
EARNINGS APPLICABLE TO COMMON STOCK	7.9%	8.2%

Operating Revenues

Operating revenues of PG&W increased by $2.3 million (3.3%) from $68.4 million for the three-month period ended March 31, 1991, to $70.7 million for the three-month period ended March 31, 1992.

Gas operating revenues decreased by $1.3 million (2.2%) from $60.3 million for the three-month period ended March 31, 1991, to $59.0 million for the three-month period ended March 31, 1992, primarily as a result of a price decrease effective December 1, 1991, due to decreased costs of purchased gas. This decrease was partially offset by increased sales to residential heating and industrial customers. Although heating degree days were 4.2% lower than normal during the first quarter of 1992, they were 10.0% higher than in the similar quarter in 1991. Largely because of the colder weather and the addition of new customers, total gas deliveries for the quarter were 9.8% higher than in the corresponding quarter in 1991.

Water operating revenues increased by $3.6 million (44.8%) from $8.1 million for the three-month period ended March 31, 1991, to $11.7 million for the three-month period ended March 31, 1992. This increase was primarily the result of rate increases which the PPUC allowed PG&W effective March 23, 1991, for customers in the Scranton Water Rate Area, and effective January 30, 1992, for customers in the Spring Brook Water Rate Area served exclusively by the Nesbitt Water Treatment Plant. These increases are designed to produce additional annual revenue of $16.9 million, as more fully explained below under "Rate Matters."

Operating Expenses

Operating expenses, including depreciation and income taxes, increased $416,000 (0.7%) from $57.6 million for the three-month period ended March 31, 1991, to $58.0 million for the three-month period ended March 31, 1992. As a percentage of operating revenues, total operating expenses decreased from 84.3% during the first quarter of 1991 to 82.1% during the first quarter of 1992.

The cost of gas decreased by $3.2 million (8.7%) from $36.9 million for the three-month period ended March 31, 1991, to $33.7 million for the three-month period ended March 31, 1992. This decrease was the result of significantly decreased costs for purchased gas, the effect of which was partially offset by a 20.9% increase (2.3 billion cubic feet) in the volume of gas sold during the three-month period ended March 31, 1992, compared to the corresponding period in 1991. This increased volume was attributable to colder weather, the switching of certain industrial customers from transportation to sales service and the addition of new customers. Exclusive of charges related to take-or-pay costs absorbed by PG&W, which totaled $441,000 in the three-month period ended March 31, 1991, and $71,000 in the three-month period ended March 31, 1992, the gross margin on gas operations (gas operating revenues less the cost of gas) increased $1.5 million or 6.4% in 1992. This increase was primarily the result of increased sales to residential heating and industrial customers.

Other than the cost of gas and income taxes, operating expenses increased by $2.1 million (12.1%) from $17.7 million for the three-month period ended March 31, 1991, to $19.8 million for the three-month period ended March 31, 1992. This increase was largely attributable to a $957,000 increase in other taxes, principally as a result of tax rate increases enacted by the Commonwealth of Pennsylvania in August, 1991, and a $506,000 increase in depreciation, primarily as a result of capital additions and the change in March, 1991, from a 4% compound interest to a straight-line method of depreciation with respect to certain water plant. Also contributing to the increase was the absence of any deferred treatment plant costs, which totaled $765,000 in the first quarter of 1991. See "-Deferred Treatment Plant Costs and Interest."

Income taxes increased by $1.5 million (48.1%) from $3.1 million in 1991 to $4.6 million in 1992 due to a higher level of income before income taxes (for this purpose, operating income net of interest charges) and an increase in the state income tax rate enacted by the Commonwealth of Pennsylvania in August, 1991.

Deferred Treatment Plant Costs and Interest

As approved by an order of the PPUC entered September 5, 1990, PG&W has deferred all operating expenses, including depreciation and property taxes, and the carrying charges (equivalent to the allowance for borrowed funds used during construction) relative to the four new Scranton Area water treatment plants and related facilities from the dates of commercial operation of the plants until March 23, 1991, the effective date of the Scranton Area water rate increase approved by the PPUC on March 22, 1991. As of March 31, 1992, a total of $5.1 million of costs, consisting of $2.3 million of operating expenses and $2.8 million of carrying charges, had been so deferred. The deferral of these costs resulted in an increase in earnings for the three-month period ended March 31, 1991, of $981,000, net of related income taxes. PG&W intends to seek recovery of such amounts in its next rate increase request relative to the Scranton Water Rate Area, which it plans to file with the PPUC during the latter part of 1992. There is no clear precedent as to whether the PPUC is required to allow such recovery. Therefore, there can be no assurance that the PPUC will allow such recovery. However, the PPUC has, in a 1990 decision involving another Pennsylvania utility, allowed recovery, over a ten-year period, of deferred costs associated with the construction of a nuclear power plant on the basis that these costs were extraordinary and nonrecurring. PG&W believes that the deferred costs associated with the Scranton Area water treatment plants satisfy these criteria and should qualify for treatment similar to that accorded by the PPUC in the decision described above. On this basis, PG&W believes that the recovery of these costs will be allowed by the PPUC in future rate increases, although any recovery may be phased-in over an extended period of time. However, if such recovery is not allowed by the PPUC, which action in all likelihood would not occur prior to PG&W's 1993 fiscal year, PG&W would be required to write-off the deferred costs against income, which would reduce net income by approximately $3.0 million, net of the related income tax effect, for the period in which the write-off was recorded. Depending upon the level of PG&W's earnings at such time, the write-off could reduce earnings to a level which could violate certain financial covenants contained in certain debt instruments of PEI and PG&W and which could preclude PG&W from issuing additional debt and preferred stock. In such a case, PEI and PG&W would attempt to obtain waivers from their respective lenders. The failure to obtain such waivers could result in a default under such debt instruments and have a material adverse effect on PG&W. In addition, such a denial of the recovery of deferred costs would likely alter PG&W's current plan to similarly defer operating expenses and carrying charges in 1992, 1993 and 1994 following the respective anticipated completion of the three Spring Brook Area water treatment plants now under construction. Such a denial could also adversely affect the amount of dividends that PG&W would pay to PEI during the period the deferral would otherwise have occurred.

Operating Income

As a result of the above, total operating income increased by $1.9 million (17.4%) from $10.7 million for the three-month period ended March 31, 1991, to $12.6 million for the three-month period ended March 31, 1992, and increased as a percentage of total operating revenues from 15.7% in 1991 to 17.9% in 1992. Operating income from gas utility operations increased $711,000 (8.1%) from $8.8 million in 1991 to $9.5 million in 1992, due primarily to a $1.9 million increase in gross margin, the effect of which was partially offset by increases in depreciation, income and other taxes. Operating income from water utility operations increased $1.0 million from $2.3 million in 1991 to $3.3 million in 1992, due primarily to the $15.0 million increase in annual revenue which the PPUC allowed for customers in PG&W's Scranton Water Rate Area effective March

23, 1991, and the $1.9 million increase in annual revenue which it allowed effective January 30, 1992, for customers in the Spring Brook Water Rate Area served exclusively by the Nesbitt Water Treatment Plant. These increased revenues were partially offset by increased operating expenses, depreciation, income and other taxes.

Other Income, Net and Interest Charges

Other income, net increased from $87,000 in the three-month period ended March 31, 1991, to $176,000 in the three-month period ended March 31, 1992, primarily as a result of interest earned on the intercompany advance to PEI which was repaid on January 30, 1992.

Interest charges increased by $1.6 million (37.2%) from $4.4 million for the three-month period ended March 31, 1991, to $6.0 million for the three-month period ended March 31, 1992. This increase was largely attributable to increased borrowings to finance the construction of various additions and improvements to PG&W's water utility plant, and also reflects the absence of any deferred treatment plant interest in the first quarter of 1992. Partially offsetting this increase was a $186,000 (344.4%) increase in the allowance for borrowed funds used during construction in the three-month period ended March 31, 1992, to $240,000 from $54,000 in the three-month period ended March 31, 1991. This increase was due to a greater amount of construction work-in-progress, primarily as a result of the three water treatment plants currently under construction in the Spring Brook Water Rate Area.

Earnings Applicable to Common Stock

Earnings applicable to common stock increased $336,000 (6.2%) from $5.4 million ($1.47 per share) for the three-month period ended March 31, 1991, to $5.8 million ($1.55 per share) for the three-month period ended March 31, 1992. The increased earnings for the three-month period in 1992 was the result of the matters discussed above, primarily the increase in water operating revenues resulting from the rate increases which the PPUC allowed PG&W effective March 23, 1991, and January 30, 1992, as well as the increase in gross margin on gas sales as a result of higher levels of sales to residential heating customers.

RATE MATTERS

In accordance with the Pennsylvania Public Utility Code (the "Code"), PG&W files an annual purchased gas cost rate with the PPUC. From time to time, PG&W also files for adjustments to its gas and water rates to, among other reasons, recover interest charges and depreciation expenses relating to capital expenditures, recover increased operating expenses and make adjustments to existing surcharge rates approved by the PPUC.

The following is a summary of such filings, including the reasons for and the anticipated results thereof, which had an effect on the three-month periods ended March 31, 1991 and 1992.

Gas Rate Filings

Pursuant to the provisions of the Code which require that the tariffs of gas distribution companies, such as PG&W, be adjusted on an annual basis to reflect changes in their purchased gas costs, the PPUC ordered PG&W to make the following changes to the gas costs contained in its gas tariff rates on the dates indicated:

Effective Date	Change in Rate per Thousand Cubic Feet From	To	Calculated Increase (Decrease) in Annual Revenue
December 1, 1990	$3.02	$3.20	$ 4,200,000
December 1, 1991	3.20	2.46	(20,800,000)

Such changes in gas rates have no effect on PG&W's earnings since the change in revenue is offset by a corresponding change in the cost of gas.

On April 27, 1990, PG&W filed an application with the PPUC seeking approval to recover 90% ($13.9 million based on then current estimates) of its total take-or-pay liabilities, and $250,000 of related carrying costs, through billings to customers over a four-year period beginning June 1, 1990. The PPUC approved this application effective June 1, 1990. In connection with this approval, PG&W agreed to absorb a portion of its take-or-pay liabilities. The amount to be so absorbed by PG&W is currently estimated to range between $1.7 million and $1.9 million, of which $1.7 million had been charged to expense as of March 31, 1992. As of March 31, 1992, PG&W had billed $8.3 million of take-or-pay costs to its customers and had deferred $4.3 million of such costs, including related carrying charges, for future billing to customers.

Under terms of the PPUC's Order in respect of take-or-pay obligations, the surcharge by which PG&W bills its customers for take-or-pay costs is to be adjusted annually as of June 1 to reflect changes in PG&W's total estimated liability for take-or-pay costs (which is currently projected to be as much as $19.1 million) and the portion of such costs remaining to be recovered from its customers. In accordance therewith, PG&W has filed data with the PPUC requesting approval by the PPUC of an adjustment in PG&W's take-or-pay surcharge effective June 1, 1992, based on the $9.2 million of take-or-pay costs that PG&W currently estimates will remain to be collected from its customers as of such date.

Water Rate Filings

On June 8, 1990, PG&W filed an application with the PPUC seeking a water rate increase, designed to produce $25.5 million in additional annual revenue. This rate increase request involved the approximately 54,700 customers who are now being furnished water from the one previously existing and the four new water treatment plants in the Scranton Water Rate Area. In December, 1990, PG&W and certain parties filing objections to the rate increase request reached a settlement that provided for an approximate 110% rate increase designed to produce $15.0 million of additional annual revenue to be phased-in over a two-year period under the terms of a qualified phase-in plan, pursuant to Financial Accounting Standards Board ("FASB") Statement 92 entitled "Regulated Enterprises-Accounting for Phase-in Plans." The settlement provided that $10.2 million of the increased revenue (an approximate 75% increase in rates) was to be realized through an immediate rate increase and that the remaining $4.8 million of the increased revenue (an additional 35% increase in rates) was to be realized through another rate increase one year later (at the beginning of year two of the phase-in period). The settlement also specified that the $4.8 million in billings that would be deferred during the first year of the phase-in

period was to be collected from customers in the form of a surcharge in years two through ten of the phase-in period. Finally, PG&W also agreed that it would not file for another general rate increase for the Scranton Water Rate Area prior to six months after the effective date of the second phase of the rate increase. By Order adopted March 22, 1991, the PPUC approved the settlement and permitted PG&W a water rate increase estimated to produce additional annual revenue of $15.0 million effective March 23, 1991. PG&W settled this proceeding for less than originally requested in order to obtain rate relief earlier than otherwise expected and to avoid the substantial expenses associated with further administrative and possible appellate proceedings. In accordance with the provisions of FASB Statement 92, PG&W commenced recording the entire $15.0 million increase in annual revenue allowed by the PPUC as additional revenue beginning March 23, 1991. However, pursuant to the terms of the settlement, PG&W deferred the billing of $4.8 million of the increased revenue recorded during the first year of the phase-in period (i.e., the period March 23, 1991, through March 22, 1992). Effective March 23, 1992, PG&W began to bill such amount by means of the surcharge that will be in effect in years two through ten of the phase-in period, and as of March 31, 1992, $1,600 had been so billed to its Scranton Water Rate Area customers.

On April 30, 1991, PG&W filed an application with the PPUC seeking a water rate increase, designed to produce $2.6 million in additional annual revenue. This rate increase request involved the approximately 14,300 customers in the Spring Brook Water Rate Area who are served exclusively by the Nesbitt Water Treatment Plant. PG&W and certain parties filing objections to the rate increase request reached a settlement that provided for a $1.9 million increase in annual revenue which the PPUC approved effective January 30, 1992. PG&W settled this proceeding for less than originally requested in order to avoid the substantial expenses associated with further administrative and possible appellate proceedings. On February 6, 1992, the OCA, a complainant in the rate proceeding and a signatory to the joint petition for settlement, filed a petition for reconsideration and clarification of the PPUC Order approving the settlement. On February 18, 1992, PG&W filed an answer to the OCA's petition. By Order entered February 27, 1992, the PPUC granted the OCA's petition and, as a result, the $1.9 million rate increase remains subject to further PPUC and possible appellate review. Although it cannot be certain, PG&W believes that the $1.9 million increase will not be rescinded in whole or in part or affected in any other way as a result of the OCA's petition.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity

The liquidity of PG&W is influenced significantly by the capital intensive nature of its operations and the ratemaking practices of the PPUC, which together effectively require external financing of a substantial portion of PG&W's construction expenditures. See "-Construction Expenditures and Related Financing" and "-Failure to Obtain Adequate Rate Relief and Successfully Complete Capital Market Issues." Additionally, because of the seasonal nature of its gas utility operations, it is necessary for PG&W to finance its gas purchases and increases in its customer accounts receivable with bank borrowings during certain periods of the year.

PG&W's ability to generate sufficient internal funds and to obtain the external funds that are required for its operations and construction expenditures is influenced significantly by the timing and amount of rate relief it is granted. This is a problem faced by all regulated utilities, and one that had been particularly acute with respect to PG&W because of the denial by the

PPUC in 1986, and again in 1988, as a result of water quality issues, of water rate increases requested by it. Nonetheless, PG&W has been able to generate and raise sufficient capital resources in the past, and believes that it will be granted sufficient rate relief to enable it to meet its future anticipated capital requirements, particularly in view of the increases in annual water revenue aggregating $20.2 million which the PPUC has granted PG&W since 1989 with respect to customers now being supplied with filtered water. PG&W also believes that additional rate increases will be allowed by the PPUC for the approximately 82,000 customers of PG&W who are now receiving filtered water and that increases will be granted with respect to its 48,000 other water customers, especially when they begin to receive filtered water within the next two years. The basis for such beliefs is the very low level of earnings that PG&W is currently realizing from its water utility operations and the expectation that with filtration, water quality should be less of a concern in its requests for water rate increases. Still, the scheduling of certain capital expenditures by PG&W, including an estimated $85.1 million of expenditures for various water supply and treatment facilities and associated distribution system improvements, as well as certain previously planned dam modifications, planned for the period through 1996, and also the $13.3 million of expenditures for the installation, replacement and rehabilitation of various water mains and service lines that are currently planned for the remainder of 1992, may be affected if PG&W is unable to raise the necessary capital in a timely manner because of inadequate levels of earnings. See "-Construction Expenditures and Related Financing" and "-Failure to Obtain Adequate Rate Relief and Successfully Complete Planned Capital Market Issues."

Because of limitations imposed by the terms of PG&W's preferred stock, PG&W is prohibited, without the consent of the holders of a majority of the outstanding shares of its preferred stock, from issuing more than $12.0 million of unsecured debt due on demand or within one year from issuance. PG&W had no unsecured debt due on demand or within one year from issuance outstanding as of March 31, 1992.

In addition, PG&W is prohibited from paying any dividends to PEI in the event of a default under certain of its debt instruments or failure to make any required dividend payments due holders of PG&W preferred stock. Furthermore, any failure to pay preferred stock dividends for four consecutive quarters will permit the holders of the PG&W preferred stock to elect a majority of the directors of PG&W.

The proceeds from the sale of PG&W's 9.57% First Mortgage Bonds in the principal amount of $50.0 million, which were issued on September 12, 1991, were used by PG&W to make a $15.0 million Intercompany Advance (the "Intercompany Advance") to PEI on that date and to repay $35.0 million of borrowings under the Credit Agreement.

As a result of the repayment by PEI of the $15.0 million Intercompany Advance on January 30, 1992, and its contribution of $7.0 million to PG&W on such date, PG&W believes it will be able to raise additional funds in the capital markets and thereby proceed with other financings planned for 1992. These financings include the issuance of $25.0 million of preferred stock and $30.0 million of first mortgage bonds, the sale of an additional $6.0 million of common stock to PEI and refinancings of maturing debt. PG&W expects such financings will provide sufficient funds for its working capital needs, as well as its construction program, through at least the first quarter of 1993. In addition, as of May 13, 1992, $38.8 million was available for borrowing by PG&W under the terms of the Credit Agreement.

PG&W believes that PEI will be able to issue the $30.0 million of long-term debt which will be necessary for PEI to repay the $19.0 million principal amount of its currently outstanding debt which is due on July 15, 1992, and also allow it to purchase the additional $6.0 million of PG&W common stock and to make the $4.0 million demand loan to PG&W that are currently planned for 1992. However, if PEI is unable to raise at least $19.0 million of such funds or to negotiate an extension to the Second LTCB Agreement and the FEB Agreement, PEI would be in default under the Second LTCB Agreement and the FEB Agreement. Such a default would, absent waivers, cause cross-defaults under debt instruments of PG&W and the potential acceleration of debt of PG&W, all of which would, if such acceleration occurs, have a material adverse effect on PEI and PG&W. Additionally, in the event that PEI does not obtain a commitment letter reasonably satisfactory to the banks parties to the Credit Agreement regarding the refinancing of the $19.0 million of its currently outstanding debt by June 15, 1992, PG&W would, absent a waiver, be obligated to repay all amounts outstanding under the Credit Agreement on June 15, 1992. See "-Current Maturities of Long-Term Debt and Preferred Stock."

Under the terms of each of the Letter of Credit Agreement dated as of January 1, 1989, as amended (the "NAB Agreement"), between PG&W and National Australia Bank, Limited, New York Branch ("NAB"); the Letter of Credit Agreement dated as of October 1, 1987, as amended (the "October 1987 SBC Agreement"), between PG&W and Swiss Bank Corporation, New York Branch ("SBC"); and the Letter of Credit Agreement dated as of December 1, 1987, as amended (the "December 1987 SBC Agreement"), between PG&W and SBC (collectively, the "Letter of Credit Agreements"), PG&W is required to maintain a minimum interest coverage ratio (generally defined as net income available for interest divided by actual debt interest expense) as of the end of each fiscal quarter for the immediately preceding twelve-month period. If PG&W fails to meet such minimum ratio for three consecutive fiscal quarters, a default will occur under the terms of the respective Letter of Credit Agreements. Although PG&W did meet the minimum ratio for the fiscal quarter ended March 31, 1992, required by the NAB Agreement, it did not meet the minimum ratio for such quarter that was required under the terms of the October 1987 SBC Agreement and the December 1987 SBC Agreement as then in effect. However, as a result of amendments to the October 1987 SBC Agreement and the December 1987 SBC Agreement dated May 11, 1992, by which the calculation of the interest coverage ratio under the terms of such agreements was modified effective March 31, 1992, PG&W has met the minimum interest coverage requirement of such agreements, as so amended, for the fiscal quarter ended March 31, 1992.

PG&W believes that based on its current financial projections, it will be able to achieve sufficient levels of earnings during 1992, as a result of the $15.0 million and $1.9 million water rate increases that were effective March 23, 1991, and January 30, 1992, respectively, the utilization of the $22.0 million received from PEI in January, 1992, to repay a portion of PG&W's bank borrowings, and various cost reduction measures, to enable it to meet its interest and fixed charge coverage requirements and to give it the borrowing and other financing capability necessary for its working capital needs and planned construction program. If PG&W is not granted adequate water rate increases in 1993 and subsequent years, it will be necessary for PG&W to take various actions to reduce expenditures in order to satisfy its interest and fixed charge coverage requirements and to maintain sufficient liquidity, and thereby lessen the amount of debt and equity capital which must be raised. Among other things, such actions could involve halting further work on PG&W's water treatment plants and other planned construction, which could result in a violation of the Consent Order and potential civil penalties.

Interim Financing Practices

It is the practice of PG&W to use bank borrowings to finance certain of its construction expenditures pending the periodic issuance of stock and long-term debt. Additionally, because of the seasonal nature of its gas utility operations, it is necessary for PG&W to finance its gas purchases and increases in its customer accounts receivable with bank borrowings during certain periods of the year.

In order to so finance construction expenditures and to meet its seasonal borrowing requirements, PG&W has made arrangements for a total of $45.0 million of revolving bank credit which is due on April 30, 1993. Specifically, on April 25, 1991, PG&W entered into the Credit Agreement with the various banks with which it had previously arranged lines of credit. The purpose of the Credit Agreement was to consolidate PG&W's existing bank lines of credit, to provide for uniform terms relative to its bank borrowings and to extend the due dates of such borrowings. As such, the Credit Agreement superseded PG&W's individual bank lines of credit. The interest rate on borrowings under the Credit Agreement is the reference (i.e. prime) rate as established from time to time by Chemical Bank (currently 6-1/4% per annum). The Credit Agreement also requires the payment of a commitment fee of 1/2 of 1% per annum on the average daily amount of the unused portion of the available funds.

Current Maturities of Long-Term Debt and Preferred Stock

As of March 31, 1992, $7.5 million of PG&W preferred stock and long-term debt was required to be repaid within twelve months. In addition, the $50.0 million SBC Letter of Credit which currently secures the 1987 Series A Bonds will expire in October, 1992. The 1987 Series A Bonds are required to be secured by either a letter of credit or by other comparable credit enhancement throughout their term. If, at any time, the 1987 Series A Bonds were not to be so secured, PG&W would be required either to collateralize the 1987 Series A Bonds or to purchase or cause their redemption. The SBC Letter of Credit was issued pursuant to the October 1987 SBC Agreement. The October 1987 SBC Agreement will expire on October 20, 1992, and SBC has indicated to PG&W that currently it does not intend to extend or renew the SBC Letter of Credit. If the SBC Letter of Credit is not extended or renewed and if PG&W is not able to secure a replacement letter of credit or obtain a comparable credit enhancement, PG&W would be required either to collateralize the 1987 Series A Bonds or to purchase or cause their redemption as of October 1, 1992. PG&W intends to attempt first to obtain a replacement letter of credit or other comparable credit enhancement, and if unsuccessful to collateralize its obligation under the 1987 Series A Bonds. However, there can be no assurance that PG&W will be successful in obtaining either alternative because it is more difficult now, in general, to obtain a credit enhancement and if a credit enhancement is not available, PG&W's lenders may be unwilling to consent to the release of collateral to secure the 1987 Series A Bonds. If PG&W were unable to obtain either alternative, it would seek to sell approximately $50.0 million of first mortgage bonds or other long-term debt in order to finance the redemption or purchase of the 1987 Series A Bonds, which would, in such a circumstance, have to be consummated on or prior to October 1, 1992. While PG&W believes it will be able to successfully complete the sale of first mortgage bonds or other long-term debt, there can be no assurance that it will be successful in completing such sale or in obtaining either of the two alternatives described above. The failure to refinance the 1987 Series A Bonds or to obtain any of such alternatives would, absent waivers, result in a default under the trust indenture dated as of October 1, 1987, between the Authority and Northeastern Bank of Pennsylvania, as trustee, pursuant to which the 1987 Series A Bonds were

issued, cause cross-defaults under other debt instruments of PG&W and PEI and the potential acceleration of debt of PG&W and PEI, all of which would, if such acceleration occurs, have a material adverse effect on PEI and PG&W.

PEI presently has $19.0 million of debt outstanding pursuant to the Second LTCB Agreement and the FEB Agreement which is due on July 15, 1992, and which it intends to repay with the proceeds from other borrowings. PG&W's Credit Agreement provides that in the event PEI has not received by June 15, 1992, a commitment letter reasonably satisfactory to the banks who are parties to the Credit Agreement providing for a loan to PEI of at least $19.0 million, PG&W would become obligated, absent a waiver, to repay all amounts outstanding under the Credit Agreement on June 15, 1992. While PEI believes that it will be able to obtain a commitment letter satisfactory to the banks by June 15, 1992, there can be no assurance that it will be able to do so. In the event that PG&W is obligated to repay all amounts outstanding under the Credit Agreement on June 15, 1992, but is unable to do so or to obtain a waiver, PG&W would be in default under the Credit Agreement. Such default would, absent waivers, result in cross-defaults under other debt instruments of PG&W and the potential acceleration of other debt of PG&W, all of which would, if such acceleration occurs, have a material adverse effect on PEI and PG&W.

In addition, if PEI obtains such commitment letter but does not actually receive the $19.0 million by July 15, 1992, PEI would be unable to repay its debt to LTCB and FEB on the July 15, 1992, due date. In such a circumstance, PEI would attempt to negotiate extensions of the due date of such debt in order to avoid a default under the Second LTCB Agreement and the FEB Agreement. A default under such debt instruments would, absent waivers, cause cross-defaults under other debt instruments of PG&W and the potential acceleration of debt of PG&W, all of which would, if such acceleration occurs, have a material adverse effect on PEI and PG&W.

If PEI and PG&W were unable to successfully obtain any of the waivers described in the two preceding paragraphs, PEI and PG&W would seek to refinance or restructure the applicable debt obligations. If these efforts were unsuccessful and a substantial amount of PEI's and PG&W's debt was accelerated and became immediately due, PEI and PG&W might be forced to seek protection under federal bankruptcy laws.

PG&W believes that it will have sufficient cash flow and borrowing capacity to repay current maturities of its preferred stock and long-term debt and to meet its other obligations, based on its present earnings capability and its Credit Agreement. However, the continuing adequacy of the sources of funds described above could also be adversely affected by the timing and amount of rate relief which PG&W is granted by the PPUC, and by the inability of both PEI and PG&W to raise additional funds in the capital markets. See "-Failure to Obtain Adequate Rate Relief and Successfully Complete Planned Capital Market Issues."

Capital Stock Financing

On January 30, 1992, PG&W received a total of $22.0 million from PEI representing repayment of the $15.0 million Intercompany Advance and a $7.0 million contribution by PEI to PG&W. PG&W utilized such funds to repay bank borrowings which had been incurred primarily to finance construction expenditures.

On March 23, 1992, PG&W issued to PEI 171,779 shares of its common stock, without nominal or par value, with a stated value of $10 per share, for aggregate net proceeds of approximately $7.0 million. These shares represented capitalization of the $7.0 million contribution made by PEI to PG&W on January 30, 1992, which had been temporarily treated as an intercompany advance pending approval by the PPUC of the issuance of shares of common stock relative to such contribution.

Construction Expenditures and Related Financing

Expenditures for the construction of utility plant totaled $8.5 million during the first three months of 1992 and are estimated to be $66.5 million during the remainder of the year. The construction of water facilities by PG&W during 1992, currently estimated to cost $59.5 million, is being largely financed by internally-generated funds and bank borrowings, pending the periodic issuance of stock and long-term debt. The construction of gas facilities by PG&W in 1992, currently estimated to cost $15.5 million, is also being financed by internally-generated funds and bank borrowings, pending the periodic issuance of stock and long-term debt.

Failure to Obtain Adequate Rate Relief and Successfully Complete Planned Capital Market Issues

If PG&W is unable to obtain adequate rate relief in future rate increase applications filed with the PPUC and if the debt and equity issues planned by PG&W over the next several years are not successfully completed, PG&W would be forced to minimize cash expenditures by, among other actions, curtailing or deferring work on the final two water treatment plants and other capital projects, considering the sale of selected assets, reducing its operating expenses by, among other things, laying off personnel and reducing fringe benefits for employees and retirees, all of which could negatively impact the quality and reliability of services rendered to the public by PG&W. If PG&W were forced to curtail or defer work on the final two water treatment plants or any other significant expansion or improvement to its gas and water operations, future rate increases and resulting improvements in earnings might be delayed, and this delay could, in turn, impede the ability of PEI and PG&W to raise additional debt and equity capital which could result in a violation of the Consent Order and could subject PG&W to fines and other penalties imposed by regulatory agencies. Additionally, lenders to PEI and PG&W would have to agree to amend certain debt instruments to avoid defaults and the acceleration of maturities of certain debt, to refinance or extend maturing debt, and/or to develop debt restructuring plans. For a discussion of the effect of cross-default provisions on PG&W, see "-Current Maturities of Long-Term Debt and Preferred Stock."

PG&W believes it will be able to obtain adequate rate relief, although there can be no assurance that such rate relief will be obtained. However, if PG&W were unable to obtain adequate rate relief from the PPUC in future applications under circumstances where PG&W believed that it was entitled as a matter of law to such rate relief, PG&W would file appropriate appeals with the Commonwealth Court of Pennsylvania claiming that, contrary to law, the PPUC by its actions had denied PG&W an opportunity to earn a fair rate of return on its prudent investment in property which is used and useful in providing public utility service. PG&W also believes that PEI and PG&W will successfully complete the planned debt and equity issuances, but there can be no assurance that such debt and equity issuances will be successfully completed.

Deferred Income Tax Liabilities

In February, 1992, Financial Accounting Standards Board (FASB) Statement 109 "Accounting for Income Taxes," which supersedes previously issued income tax accounting standards, was issued. The provisions of this statement, which PG&W will adopt in 1993, are not expected to have a significant effect on PG&W's results of operations since, under existing federal law, the excess deferred taxes presently recorded will be returned to ratepayers over the average remaining lives of the property originally giving rise to those taxes. The provisions of FASB Statement 109 will, however, require PG&W to record the deferred tax liabilities on certain timing differences which have not previously been recorded because of the regulatory rate practices of the PPUC. These deferred tax liabilities will be offset by an asset representing the probable future rate recovery of such liabilities.

Postretirement Benefits

In December, 1990, FASB Statement 106 "Employers' Accounting for Postretirement Benefits Other Than Pensions" was issued. The provisions of this statement, which PG&W must adopt in 1993, will require it to record the cost of retiree health care and life insurance benefits as a liability over the employees' active service periods instead of on a benefits paid basis as is its current practice. Preliminary actuarial studies indicate that PG&W's unfunded accumulated obligation for postretirement benefits other than pensions (the "transition obligation") will approximate $32.2 million as of January 1, 1993, and that PG&W's accrued costs for postretirement benefit obligations other than pensions, including amortization of the transition obligation, will be approximately $5.3 million in 1993, based on the provisions of FASB Statement 106. These amounts are preliminary estimates. PG&W is continuing to review various assumptions and alternatives which may significantly reduce such estimates. On a benefits paid basis (PG&W's current practice), the estimated cost of such benefits in 1993 would be approximately $1.2 million. Nevertheless, the provisions of FASB Statement 106 are not expected to have a significant effect on PG&W's results of operations, since PG&W expects that the PPUC will authorize PG&W to recover in rates the additional costs which will be accrued pursuant to the provisions of FASB Statement 106. However, there can be no assurance that the PPUC will permit the recovery of such costs because the PPUC has not yet ruled on this issue. If the PPUC does not authorize the recovery of such costs, or authorizes only the recovery of a portion of those costs, PG&W's net income would be reduced beginning in 1993 by the difference between the annual cost of such benefits allowed in rates and the expense required under FASB Statement 106. Based on preliminary actuarial evaluations, if the PPUC does not authorize the recovery of any of such costs, this difference in 1993 would be approximately $4.1 million and would reduce net income of PG&W in 1993 by as much as $2.4 million, net of related income taxes. Depending upon the level of PG&W's earnings, such additional expense could reduce its earnings to a level which could violate certain financial covenants contained in the debt instruments of PEI and PG&W and which could preclude PG&W from issuing additional debt and preferred stock. In such a case, PEI and PG&W would attempt to obtain waivers from the lenders or amendments to the applicable covenants. The failure to obtain such waivers or amendments could result in a default under such debt instruments and have a material adverse effect on PG&W.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Reference is made to Item 3 of Part I of PG&W's Annual Report on Form 10-K for the year ended December 31, 1991.

Construction Litigation

On April 22, 1992, a complaint was filed in the Court of Common Pleas of Lackawanna County, Pennsylvania by the Quandel Group, Inc. ("Quandel") against PG&W in connection with the construction of PG&W's Brownell Water Treatment Plant. Specifically, Quandel, the general contractor for this project, alleges that (i) PG&W has not paid Quandel for work in connection with certain change orders issued by PG&W, (ii) PG&W has not paid Quandel for work done beyond the requirements of its contract to remediate defects resulting from improper designs furnished by PG&W, and (iii) on account of breaches by PG&W, Quandel could not complete the work to be done under the contract within the agreed contract period and was forced to incur additional costs in performing such work for which it has not been compensated. Quandel seeks approximately $1.3 million in damages plus interest. Although it cannot be certain because this proceeding is in its earliest stages, PG&W believes that this complaint is without merit and that it will prevail in this action. Furthermore, PG&W believes that in the event it does not prevail in this action, Gannett-Fleming Water Resources Engineers, Inc., the designer of the project, will be responsible for part of any damages that may be awarded. In addition, PG&W believes that a substantial portion of any amounts it might be required to pay as a result of this action would be recoverable in future rates as costs properly associated with the construction of water treatment facilities.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

10-1 Amendment No. 3, dated as of May 11, 1992, to October 1987 Reimbursement Agreement between Pennsylvania Gas and Water Company and Swiss Bank Corporation, New York Branch - filed herewith.

10-2 Amendment No. 3, dated as of May 11, 1992, to December 1987 Reimbursement Agreement between Pennsylvania Gas and Water Company and Swiss Bank Corporation, New York Branch - filed herewith.

(b) No reports on Form 8-K have been filed during the quarter for which this report is filed.

PENNSYLVANIA GAS AND WATER COMPANY

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

PENNSYLVANIA GAS AND WATER COMPANY
(Registrant)

Date: May 13, 1992 By: _____
Thomas J. Ward
Secretary

Date: May 13, 1992 By: _____
John F. Kell, Jr.
Vice President and Controller
(Principal Financial Officer and
Principal Accounting Officer)

AMENDMENT NO. 3 TO OCTOBER 1987 REIMBURSEMENT AGREEMENT

AMENDMENT NO. 3 (this "Amendment") dated as of May 11, 1992 by and between PENNSYLVANIA GAS AND WATER COMPANY, a corporation organized and existing under the laws of the Commonwealth of Pennsylvania (the "Company"), and SWISS BANK CORPORATION, NEW YORK BRANCH (the "Bank").

W I T N E S S E T H :

WHEREAS, the Company and the Bank have heretofore entered into a Letter of Credit Agreement dated as of October 1, 1987, as amended by an Amendment No. 1 to October 1987 Reimbursement Agreement dated as of September 10, 1991 and an Amendment No. 2 to October 1987 Reimbursement Agreement dated as of December 13, 1991 (as amended, the "Letter of Credit Agreement") pursuant to which the Bank has issued its irrevocable letter of credit to support certain payments in respect of the Luzerne County Industrial Development Authority Exempt Facilities Revenue Bonds, 1987 Series A (Pennsylvania Gas and Water Company Project); and

WHEREAS, the Company and the Bank desire to further amend the Letter of Credit Agreement;

NOW, THEREFORE, the parties hereto agree as follows:

1. Defined terms. Capitalized terms used herein and not otherwise defined herein shall have the respective meanings assigned to such terms in the Letter of Credit Agreement (as amended and supplemented from time to time).

2. Amendment. The Letter of Credit Agreement is hereby amended as follows:

Paragraph 5S of the Letter of Credit Agreement is hereby amended by (i) deleting the word "plus" in the fifth line thereof and inserting in lieu thereof the words ", other interest charges of the Company (to the extent deducted in determining EBIT), and" and (ii) deleting the words "both cases" in the seventh line thereof and inserting in lieu thereof the words "each case".

3. Effectiveness. The amendments contained herein shall be effective as of March 31, 1992.

4. Governing Law. This Amendment is being delivered and is intended to be performed in the State of New York, and shall be construed and enforced in accordance with, and the rights of the parties shall be governed by, the laws of such State.

IN WITNESS WHEREOF, the parties have caused this Amendment to be duly executed by their duly authorized officers as of the 11th day of May 1992.

PENNSYLVANIA GAS AND WATER COMPANY

By John F. Kell Jr.
Name: John F. Kell, Jr.
Title: Vice President and Controller

SWISS BANK CORPORATION, NEW YORK BRANCH

By _____
Name:
Title: John A. McCall
Vice President

By _____
Name:
Title: Marcia B. Burkey
Assistant Vice President

AMENDMENT NO. 3 TO DECEMBER 1987 REIMBURSEMENT AGREEMENT

AMENDMENT NO. 3 (this "Amendment") dated as of May 11, 1992 by and between PENNSYLVANIA GAS AND WATER COMPANY, a corporation organized and existing under the laws of the Commonwealth of Pennsylvania (the "Company"), and SWISS BANK CORPORATION, NEW YORK BRANCH (the "Bank").

W I T N E S S E T H :

WHEREAS, the Company and the Bank have heretofore entered into a Letter of Credit Agreement dated as of December 1, 1987, as amended by an Amendment No. 1 to December 1987 Reimbursement Agreement dated as of September 10, 1991 and an Amendment No. 2 to December 1987 Reimbursement Agreement dated as of December 13, 1991 (as amended, the "Letter of Credit Agreement") pursuant to which the Bank has issued its irrevocable letter of credit to support certain payments in respect of the Luzerne County Industrial Development Authority Exempt Facilities Revenue Bonds, 1987 Series B (Pennsylvania Gas and Water Company Project); and

WHEREAS, the Company and the Bank desire to further amend the Letter of Credit Agreement;

NOW, THEREFORE, the parties hereto agree as follows:

1. Defined terms. Capitalized terms used herein and not otherwise defined herein shall have the respective meanings assigned to such terms in the Letter of Credit Agreement (as amended and supplemented from time to time).

2. Amendment. The Letter of Credit Agreement is hereby amended as follows:

Paragraph 5S of the Letter of Credit Agreement is hereby amended by (i) deleting the word "plus" in the fifth line thereof and inserting in lieu thereof the words ", other interest charges of the Company (to the extent deducted in determining EBIT), and" and (ii) deleting the words "both cases" in the seventh line thereof and inserting in lieu thereof the words "each case".

3. Effectiveness. The amendments contained herein shall be effective as of March 31, 1992.

4. Governing Law. This Amendment is being delivered and is intended to be performed in the State of New York, and shall be construed and enforced in accordance with, and the rights of the parties shall be governed by, the laws of such State.

IN WITNESS WHEREOF, the parties have caused this Amendment to be duly executed by their duly authorized officers as of the 11th day of May 1992.

PENNSYLVANIA GAS AND WATER COMPANY

By _____
Name: John F. Kell, Jr.
Title: Vice President and Controller

SWISS BANK CORPORATION, NEW YORK BRANCH

By _____
Name: John A. McCall
Title: Vice President

By _____
Name: Marcia B. Burkey
Title: Assistant Vice President